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TAGS: EIND ECON ETRD AS
SUBJECT: RIO TINTO EXECUTIVE: GOA LIKELY TO APPROVE CHINESE INVESTMENT

REF: A. A) CANBERRA 180
¶B. B) CANBERRA 143
¶C. C) CANBERRA 117

Classified By: Michael E. Thurston, Consul General, for reasons 1.4 (d)

Summary

¶1. (C/NF) Rio Tinto Managing Director Stephen Creese told Charge that concerns over increasing unemployment will likely lead the GOA to conditionally approve a proposed $19.5 billion investment by Chinese state-owned Aluminum producer Chinalco. Although the deal would grant Chinalco two of Rio's 17 board seats, Creese insists that Chinalco will not receive commercially sensitive information. The Chinalco investment would enable China to hedge against future aluminum price increases and to improve future supplies of iron ore, but Creese noted that Rio would in turn gain access to PRC policy makers as well as exploration rights in China. In addition to the politically charged question of a GOA approval, the deal also faces required approvals from CFIUS, the PRC, Rio's board, and a non-competition approval from Germany. End Summary.

Prospects for Chinalco Deal

¶2. (C/NF) During a March 11 meeting at Rio Tinto's Melbourne headquarters, Managing Director Stephen Creese told Charge that that the GOA "will have a hard time saying no" to a proposed US$19.5 billion investment by Chinalco due to the amount of jobs at stake (reftels). Creese believes the GOA will impose conditions on the deal to publicly address "xenophobic" worries that have sprung up over foreign ownership, but he was confident that the deal would eventually go through. He noted that both the Western Australian and Queensland Premiers have publicly supported the deal. In addition to seeking approval from Australia, the deal still must be approved by CFIUS, Rio Tinto's board, the PRC, and must receive a non-competition approval from Germany due to control issues over convertible bonds.

¶3. (C/NF) Responding to Charge's question about the wider significance of the deal vis-a-vis long term PRC interests, Creese noted that China is undoubtedly trying to hedge against future aluminum price increases. He also noted that the PRC has a strategic interest in keeping supply lines open for future growth. As part of the deal, an associated joint marketing company will be established to help sell iron ore back to China. While Creese noted that this is, in part, a strategic assurance that China will receive a share of future iron ore production, he said that Rio's board will still maintain control over these decisions.

¶4. (C/NF) Creese organized his briefing in such a way as to

indicate that Rio had examined a large number of solutions to tackling their post-Alcan debt woes before agreeing to run with the Chinalco offer. (Note: Rio has approximately $18 billion in payments due in late 2009 and 2010 resulting from its very expensive takeover of Canadian aluminum producer Alcan at the height of the resource boom in 2007. End note.) Creese went on to say that he was frustrated that companies had recently "come out of the woodwork with offers to buy Rio assets at below basement prices." He implied that mining rival BHP Billiton was chief among these and all but accused the company of sabotaging the Chinalco deal in order to allow BHP to make another pass at buying Rio assets on the cheap.

Impact of Chinalco Board Members?

¶5. (C) As part of the deal, Chinalco will be entitled to two seats on an expanded 17-member Rio Tinto board. Creese said that the board will be structured in such a way to prevent Chinalco members from receiving "commercially sensitive information." One of these two board members would likely be an academic from outside China, he said. In addition, he noted that the board does not set iron ore prices; this is done by a separate "iron ore marketing group" within Rio.

Background on the Deal

¶6. (SBU) The Chinalco deal is a two-part US$19.5 billion capital injection into Rio Tinto. The first $12.3 billion will be spent on strategic joint ventures in iron ore and aluminum that will allow Chinalco a maximum ownership of 15

percent in these ventures except in the case of one interest (NFI) in Queensland which will be a 50/50 partnership. The second $7.2 billion is a two-tranche convertible bond deal. Should all the bonds be converted to equity shares, Chinalco's stake would rise to 18 percent. For additional information on the proposed Chinalco investment, see ref. B.

¶7. (C) Creese said UK shareholders had protested the Chinalco deal on the basis of the principal of preemption which, they claim, should have allowed them first rights to any bonds issue. Rio's board responded by saying that the bonds deal was part of a wider, two-part program aimed at raising enough capital to confront debt as well as to allow for the expansion of several key projects. In addition, Rio Tinto benefits by acquiring rights to explore in China as well as gaining access to PRC policy makers. Referring to the sudden departure of Chairman designate Jim Leng on the eve of the announcement of the Chinalco deal, Creese said this was solely due to "irreconcilable differences of opinions" between Leng and the board.

Climate Change

¶8. (SBU) Rio is studying the Rudd government's Carbon Pollution Reduction Scheme (CPRS) in depth. Creese believes that it is roughly consistent with the GOA's White Paper on the environment and wants to see the details of the legislation. "The devil will be in the details," he said. Rio opposes a carbon tax because it "does not drive environmental outcomes and gives governments too much leverage." Rio advocates a slow start and is worried about Australia getting "too far out ahead of the pack."

Comment

¶9. (C/NF) Creese made a clear effort to downplay the influence Chinalco might exert on Rio Tinto should the deal be approved. He stressed that Rio had given away as little control as possible for the greatest amount of money. With commodity markets widely expected to be slow until late 2010

and credit still tight in Australia, Rio Tinto is under substantial pressure to bring its balance sheet closer to positive territory. Opposition leader Malcolm Turnbull is using rising unemployment as his primary battle cry against the Rudd government which is trying to hang on to as many jobs as possible.

THURSTON